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No. 89-1448

In The

Supreme Court of the United States

October Term, 1989

VIRGINIA BANKSHARES, INC., et al.,

Petitioners,

v.

DORIS I. SANDBERG, et al.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

and

BRIEF FOR THE AMERICAN CORPORATE COUNSEL ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Pursuant to Rule 37.2 of the Rules of this Court, the American Corporate Counsel Association respectfully moves for leave to file the attached brief amicus curiae. Counsel for petitioners has granted consent to file. Consent was requested from counsel for respondents, but no response to that request has been received.

ACCA is a national bar association with 34 local chapters across the country, which is devoted exclusively to the professional activities of attorneys on the legal staffs of corporations and other business entities in the private sector. ACCA has approximately 7,800 members employed as corporate counsel by some 3,500 organizations. Many of these members are the chief legal officers of their client corporations. In their professional activities, members of ACCA are confronted on a regular basis with issues concerning the disclosure of material facts required by the federal securities laws, including federal proxy legislation. ACCA's members are intimately involved in giving legal advice and formulating company policy on disclosure matters and in advising management on pending litigation.

ACCA's members have a strong interest in defending state corporate governance statutes that limit civil liabilities of corporate officers and directors. Like 37 other states, Virginia has placed a ceiling on directors' and officers' liabilities to encourage competent persons to assume positions of responsibility in business corporations and to avoid chilling their performance of duty. The sweeping implied cause of action recognized by the lower courts in this case nullifies these statutory protections and exposes ACCA's members' clients to liabilities that are contrary to state public policy.

The attached amicus curiae brief addresses the federalism issues raised by the court of appeals' ruling from the perspective of persons who have direct experience with the practical impact of stockholder litigation and

state legislation designed to place reasonable constraints on such litigation.

Respectfully submitted,

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BRIEF FOR THE AMERICAN CORPORATE COUNSEL ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

STATEMENT OF INTEREST

As explained in the foregoing motion for leave to file a brief amicus curiae, the members of the American Corporate Counsel Association ("ACCA") have a strong interest in the issues raised by the petition for a writ of certiorari. The court of appeals' ruling raises significant

uncertainties regarding the performance of ACCA's members' corporate responsibilities and also frustrates state legislation designed to protect the officers and directors they counsel against unconstrained liabilities harmful to shareholders, depositors, and employees of affected companies.

SUMMARY OF ARGUMENT

By its recognition of an implied federal cause of action that greatly exceeds the scope of prior decisions of this Court and other circuits, the court of appeals has disregarded legislation of the Commonwealth of Virginia designed to protect against the adverse effects of open-ended civil liabilities for corporate officers and directors. This Court has warned against creation of implied causes of action that usurp the public policies embodied in state laws and has insisted on application of principles of federalism in this very context. The Fourth Circuit's disregard of these principles of federalism brings its ruling into conflict with this Court's decision in *Santa Fe Industries v. Green*, 430 U.S. 462 (1977).

The Virginia corporate governance statutes that have been circumvented by the Fourth Circuit's ruling do not stand alone. As explained in this brief, 37 other states have adopted similar laws as part of recent corporate law reform initiatives. These statutes protect shareholders, depositors and employees of affected companies by constraining liabilities that deter competent persons from assuming positions of responsibility in business corporations.

The decision of the court of appeals has profound importance to corporate counsel and their clients. This Court should grant the petition for certiorari and reverse the erroneous ruling of the court of appeals.

ARGUMENT

The gist of the complaint in these cases is that minority shareholders of the First American Bank of Virginia received inadequate compensation for their shares when the bank merged with a subsidiary of its parent company holding 85% of the outstanding shares, and that the bank's directors labored under a conflict of interest when they approved the merger. These are the traditional elements of a state-law complaint for appraisal or breach of fiduciary duty.

The Fourth Circuit went to extraordinary lengths to convert these claims into federal securities claims. First, it accepted the boot-strap theory that the bank's directors committed securities fraud by failing in the proxy statement to characterize their own conduct as a breach of fiduciary duty, and by affirmatively characterizing the transaction they approved as "fair." Second, the court found that millions of dollars in damages must be paid for the alleged defects in the proxy statement, even though the individual plaintiff concededly had not relied upon the proxy statement (indeed, had affirmatively voted against the proposed merger), the vote of the minority shareholders could not have influenced the merger, and the shareholders had tried without success to

enjoin the merger or secure an appraisal remedy in Virginia court.

The practical effect of "federalizing" this controversy through these theories is to nullify carefully considered policy determinations of the Virginia legislature and to encourage the circumvention of state courts in the resolution of state-law claims. As explained by the Virginia Circuit Court, the Virginia General Assembly, in order to protect depositors against impairment of bank capital, has withheld an appraisal remedy of the very type now mandated by the Fourth Circuit. Pet. App. 32a. Moreover, the Virginia legislature has placed a cap on the liability of corporate directors at $100,000 (or one-year's compensation) to protect against unlimited personal liabilities. *Id.* at 23a. The Fourth Circuit's creation of an implied remedy under the federal securities laws runs roughshod over both of those limitations. Ironically, the court below acknowledged that these limitations applied precisely to this fact situation, yet it applied them only to the stockholders' state-law claims and placed no limitations whatsoever on their "implied" federal cause of action. *Id.* at 23a, 29a.

The Fourth Circuit's expansive ruling threatens to undermine not only the legislative policies of the Commonwealth of Virginia, but also those of many other states that have struggled to restrain the sharp escalation in directors' liability. If state-law claims may be transmuted into securities claims by the boot-strap theories employed in these cases, the corporate law of these states will suffer serious and unjustifiable injury.

As this Court has explained, "[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to shareholders, state law will govern the internal affairs of the corporation." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479 (1977). "A state has an interest in promoting stable relationships among the parties involved in the corporations it charters," and "[e]very State in this country has enacted laws regulating corporate governance." *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 89, 91 (1987). Among the most important corporate governance statutes enacted in the last decade are laws designed to shield corporate directors against excessive civil liabilities.

When Virginia passed its director liability law, "the market for directors' and officers' liability insurance was in disarray." Goolsby, *Virginia Corporation Law & Practice* §10.1, p. 126 (Prentice-Hall). The people of Virginia perceived a pressing need for liability reform because of "genuine concern that a mistake in judgment, when viewed with the benefit of hindsight, could trigger financial ruin for individual directors." *Id.* at 127. The Virginia General Assembly responded by imposing a mandatory cap on liability and by allowing shareholders to further reduce damages exposure by amending corporate bylaws. The legislature made an exception only for "knowing" and "willful" misconduct. Va. Code Ann. §13.1-692.1[1]

[1] The Virginia act applies broadly to "any proceeding" brought by or on behalf of shareholders against corporate officers or directors. The legislature withdrew protection only

(Continued on following page)

Virginia's law is part of a national trend. "One of the principal themes of corporate governance in the second half of this decade has been protection of corporate directors and officers from personal liability for money damages." Hanks, *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 Bus. Law. 1207 (1988). In addition to Virginia, Delaware, and Indiana – the first states to adopt such laws – "forty other states have adopted some form of legislation designed to reduce the risks of directors' personal liability for money damages." *Id.* at 1209. Some of these states have adopted self-executing limitations on liability. Others authorize shareholders to adopt their own limitations. *Id.* at 1210.

These laws are not self-serving prescriptions for the personal welfare of corporate directors. Rather, they serve to protect the welfare of *shareholders* by ensuring that they receive the benefit of competent management and reasonable insurance costs. As a result of escalating liability triggered by expansive judicial rulings in the

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in narrow circumstances. "Because the unprotected conduct involved intentional wrongdoing, the business leaders were not concerned that such conduct would trigger unlimited liability." Goolsby, *supra* at p. 127 n. 13. Many other states withdraw protection only from willful and wanton conduct. *See e.g.*, Nev. Rev. Stat. §78.036(1) (Supp. 1989) ("intentional misconduct, fraud or a knowing violation of law"); Ind. Code Ann. §23-1-35-1(e) (Burns Supp. 1988) ("willful misconduct or recklessness"); Ohio Rev. Code Ann. §1701.59(D) (Anderson Supp. 1989) ("deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation").

early part of the past decade, director and officer (D&O) insurance became prohibitively costly. "For many companies, especially start-up and smaller companies, the insurance was no longer affordable, and some companies were not able – and may still be unable – to obtain quotes at any price. According to the *Wall Street Journal*, premiums for D&O insurance increased over 360% in one year. Almost immediately, outside directors of many major publicly-held corporations began to resign or not stand for re-election rather than continue to serve with inadequate or no insurance." *Id.* at 1209.

Staggering liability risks for board members have had a deleterious impact on the welfare of the companies they serve. "With the onslaught of litigation and lack of protection, some corporations have found it harder not only to prevent directors from resigning, but also to attract talented board members." Note, *New York's Response to the Director and Officer Liability Crisis*, 54 Brooklyn L. Rev. 1305, 1315 (1989).[2] In view of the overriding need to retain qualified directors and to purchase insurance at reasonable cost, shareholders have voted overwhelmingly to protect their interests by exercising statutory options to limit directors' liability. See Note, *The Limitation of Directors' Liability: A Proposal for Legislative Reform*, 66 Tex. L. Rev. 411, 438 (1987) ("Of the corporations that have presented or plan to present charter provisions to shareholders under the new Delaware law, initial

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[2] This study notes that "[w]hen the Armada Corporation's D&O Policy was cancelled last year, 80 percent of the Board's members resigned in fear of personal liability exposure." *Id.* at 1316 n.62.

signs indicate that nearly ninety percent [of those corporations] have opted for no-liability provisions").[3]

The broad-based reform movement to rationalize liability rules applicable in stockholder litigation would suffer a stunning setback if the Fourth Circuit's judgment in this case were permitted to stand. By inviting into federal court this thinly-disguised controversy over breach of fiduciary duty, the Fourth Circuit has eviscerated Virginia's policy determination that appraisal remedies should *not* be available in bank merger cases and that individual directors should *not* be exposed to unconstrained class action liabilities. It also has encouraged litigants wishing to sidestep state courts to bring their state-law complaints into already over-burdened federal courts under an implied cause of action theory. It is a profound understatement to say, as in *Santa Fe Industries*, that "this extension of the federal securities laws would overlap and quite possibly interfere with state corporate law." 430 U.S. at 479.

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[3] The chart set forth in the appendix to this brief summarizes liability restrictions in 37 states. The policies of those states would be circumvented by the Fourth Circuit's ruling in this case. That ruling could be used to transform almost any claim of breach of fiduciary duty into a federal securities case. Evasion of state law liability limitations would become an exercise in artful pleading.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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April 6, 1990

APPENDIX

STATE STATUTES LIMITING CIVIL LIABILITIES OF CORPORATION DIRECTORS*

ARIZONA Ariz. Rev. Stat. Ann. §10-054(A)(9) (Supp. 1989)	Charter Option
ARKANSAS Ark. Stat. Ann. §4-27-202(B)(3) (Supp. 1989)	Charter Option
CALIFORNIA Cal. Corp. Code §§204(a)(10), 204.5 (West Supp. 1990)	Charter Option
COLORADO Colo. Rev. Stat. §7-3-101(u) (Supp. 1989)	Charter Option
DELAWARE Del. Code Ann. tit. 8, §102(b)(7) (Supp. 1988)	Charter Option

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* "Charter option" statutes permit shareholders to curtail or eliminate liability by charter amendment. "Self executing" statutes operate by their own force to curtail liabilities.

FLORIDA Fla. Stat. Ann. §607.1645 (West 1990)	Self-Executing
GEORGIA Ga. Code Ann. §14-2-202(b)(4) (1989)	Charter Option
IDAHO Idaho Code §30-1-54(2) (Supp. 1989)	Charter Option
INDIANA Ind. Code Ann. §23-1-35-1(e) (Burns Supp. 1988)	Self-Executing
IOWA Iowa Code Ann. §§491.5(8), 496A.49(13) (West Supp. 1989)	Charter Option
KANSAS Kan. Stat. Ann. §17-6002(b)(8) (1988)	Charter Option
LOUISIANA La. Rev. Stat. Ann. §12:24(c)(4) (West Supp. 1990)	Charter Option
MAINE Me. Rev. Stat. Ann. tit. 13-A, §716 (Supp. 1989)	Self-Executing

MARYLAND Md. Corps. & Ass'ns Code Ann. §§2-104(b)(8), -405.2 (Supp. 1989)	Charter Option
MASSACHUSETTS Mass. Gen. Laws Ann. ch. 156B, §13(b)(1½) (West Supp. 1989)	Charter Option
MICHIGAN Mich. Comp. Laws Ann. §450.1209(c) (West Supp. 1989)	Charter Option
MINNESOTA Minn. Stat. Ann. §§302A.111(4)(u), .251(4) (West Supp. 1990)	Charter Option
MONTANA Mont. Code Ann. §35-1-202(2)(a)(v), (2)(b) (1989)	Charter Option
NEBRASKA Neb. Rev. Stat. §21-2035(2) (Supp. 1988)	Charter Option
NEVADA Nev. Rev. Stat. Ann. §78.037(1) (Michie Supp. 1989)	Charter Option
NEW JERSEY N.J. Stat. Ann. §17-9A-3(A)(10) (West Supp. 1989)	Charter Option

NEW MEXICO N.M. Stat. Ann. §53-12-2(E) (Supp. 1989)	Charter Option
NEW YORK N.Y. Bus. Corp. Law §402(b) (McKinney Supp. 1990)	Charter Option
NORTH CAROLINA N.C. Gen. Stat. (1990) §§55-2-02(b)(3), 55-8-30(e)	Charter Option
OHIO Ohio Rev. Code Ann. §1701.59(D) (Anderson Supp. 1989)	Self-Executing
OKLAHOMA Okla. Stat. Ann. tit. 18, §1006(B)(7) (West. Supp. 1990)	Charter Option
OREGON Or. Rev. Stat. Ann. §60.047(2)(c) (1988)	Charter Option
PENNSYLVANIA 42 Pa. Cons. Stat. Ann. §8364 (Purdon Supp. 1989)	Charter Option
RHODE ISLAND R.I. Gen. Laws §7-1.1-48(a)(6) (Supp. 1988)	Charter Option

SOUTH DAKOTA S.D. Codified Laws Ann. §47-2-58.8 (Supp. 1989)	Charter Option
TENNESSEE Tenn. Code Ann. §48-12-102(b)(3) (1988)	Charter Option
TEXAS Tex. Rev. Civ. Stat. Ann. art. 1302-7.06 (Vernon Supp. 1990)	Charter Option
UTAH Utah Code Ann. §16-10-49.1 (Supp. 1989)	Charter Option
VIRGINIA Va. Code Ann. §13.1-692.1 (1989)	Self-Executing
WASHINGTON Wash. Rev. Code Ann. §23A.12.020(10)(d) (Supp. 1989)	Charter Option
WISCONSIN Wis. Stat. Ann. §180.307 (West Supp. 1989)	Self-Executing
WYOMING Wyo. Stat. §17-16-834 (1989)	Charter Option